*F/SMA
2/22/08*

DEPARTMENT OF VETERANS AFFAIRS
OFFICE OF THE SECRETARY
POST OFFICE BOX 942895
SACRAMENTO, CALIFORNIA 94295-0001
Telephone: (916) 653-2158
Fax: (916) 653-2456

February 22, 2008

Michael C. Genest, Director
Department of Finance
State Capitol, Room 1045
Sacramento, CA 95814

Dear Director Genest:

In accordance with the Financial Integrity and State Managers Accountability Act of 1983, Government Code Sections 13400 through 13407, I am submitting the enclosed report describing the review of our systems of internal and management controls for the biennial period ending December 31, 2007.

As statutorily required, the Department of Veterans Affairs is in compliance with Government Code Section 12439.

Thomas Johnson, FACHE
Secretary

Enclosure

cc: Governor Arnold Schwarzenegger
        Joint Legislative Audit Committee
        Bureau of State Audits
        State Library
        Jack Kirwan, Deputy Secretary for Administration
        JP Tremblay, Deputy Secretary for Legislation and Communications
        Robert Wilson, Deputy Secretary/Chief Counsel

HONORING CALIFORNIA'S VETERANS

California Department of
Veterans Affairs

Biennial Report
on the
Adequacy of Internal Accounting and Administrative Control

In compliance with the
Financial Integrity and State Manager's Accountability Act of 1983

December 31, 2007

Introduction

The California Department of Veterans Affairs (the Department) has completed its evaluation of the effectiveness of its internal accounting and administrative controls for the period ending December 31, 2007. This report is in response to the requirements of Government Codes 13400 through 13407, known as the Financial Integrity and State Manager's Accountability Act of 1983 (FISMA).

Background

Government Codes 13400 through 13407, known as the Financial Integrity and State Manager's Accountability Act of 1983 (FISMA), was enacted to reduce the waste of resources and strengthen accounting and administrative control. FISMA requires each state agency to maintain effective systems of internal accounting and administrative control, to evaluate the effectiveness of these controls on an ongoing basis, and to biennially review and prepare a report on the adequacy of the agency's systems of internal accounting and administrative control.

Scope and Methodology

In an effort to get an accurate measurement of the "adequacy of (CDVA) systems of internal accounting and administrative control" the Department undertook a multi-phase review to include: 1) prior internal control audits, 2) a survey of recent management reviews, and 3) an assessment of risks to our programs. The review was designed to take a high level examination of the current state of management controls as of the end of calendar year 2007 in terms of correcting previously identified problems and mitigating potential future problems (risks) in our program execution. This review was designed to provide executive management with a tool to decide where attention should be focused to ensure the Department is carrying out its mission in a fiscally and operationally sound manner. The detailed instructions used to conduct the review are reported in Appendix A.

Summary of Results

The review identified <u>no material inadequacy or material weakness</u> in the Department's systems of internal accounting and administrative control that prevent the Secretary from stating that the Department substantially complies with the intent of FISMA.

While the review conducted by the Department was very informative in evaluating internal and management controls, and identifying risks to program execution, it became clear during the exercise that the Department has reached a size and complexity wherein a permanent, well structured internal control function must be established. This non-material finding identified as a result of this review will be corrected through the development and implementation of a management control review function within the Department.

The review highlighted some areas for continued diligence and oversight by executive management, but did not identify any additional risks not already being tracked and monitored by executive management.

Survey of Prior Management Studies

The Department conducted a department-wide survey of any management studies assessing management controls or operational effectiveness conducted, or with reports dated, between January 1, 2006 and December 31, 2007. Management studies were defined to include any audits, studies, assist visits, licensing surveys, management reviews, reports, etc. Program staff identified thirty-nine studies meeting the established criteria including:

- Federal and state licensing agencies;
- External and internal management reviews;
- Local oversight or coordinating agencies;
- Occupational safety reviews;
- HIPPA Security Assessment.

This body of work represents the on-going efforts of the Department to assess the effectiveness of its management controls. A detailed listing of all the management control reviews conducted in the last two years can be found in Appendix B.

Program Risk Assessment

The Department then identified major projects, operational changes, or changes from external sources, currently under way or proposed in the next twelve months including any incomplete corrective actions identified in the "Survey of Prior Studies." The programs assessed the level of risk to departmental operations through a structured risk assessment and management process. The assessment was defined to be at a fairly high level which combined any multiple, specific risks into a statement of overall project risk or risk to successful program execution.

Risk assessment was based on a subjective evaluation of: a) the probability of an adverse outcome in project implementation, program execution, or through external influences on programs; b) the impact any adverse outcome might have on existing or new programs and/or project implementation; c) the timeframe in which an adverse outcome might occur. These factors were then used to determine risk exposure and risk severity through a structured matrix evaluation process.

Program staff identified thirty-nine specific projects or program areas meeting the established criteria and evaluated the inherent risk associated with those projects/programs. Additionally they identified appropriate strategies (and associated action items) to address those risks including:

a) *Research* – Conduct additional research into the causes, apparent risk, and potential mitigation of the identified risks;

b) *Accept* – The identified risk(s) is acceptable without any further action;

c) *Mitigate* – Action is required to reduce (mitigate) either the causes of the risk itself or the potential impact;

d) *Watch* – No immediate action is required, however, the risk assessment should be reviewed periodically to identify any significant changes.

Findings

Using the results of the operational risk assessment process, executive management reviewed all Risk Management Forms with a risk severity of "High" to evaluate if the risk management strategy and actions were sufficient. Additionally, executive management evaluated the risk assessments to determine if any resulted in material weakness in the Department's system of internal accounting and administrative control. Finally, the executive management team identified appropriate follow-on management reviews.

Material Weaknesses

None of the risk assessments and study findings were evaluated as resulting in material inadequacy or material weakness in the Department's system of internal accounting and administrative control that would prevent the Secretary from stating that the Department substantially complies with the intent of the FISMA.

Non-material Findings

While the review conducted by the Department was very informative in identifying risks to program execution, it became clear during the exercise that the Department has reached a size and complexity wherein a permanent, well-structured internal control function should be established. This finding results from the need to improve control functions as the Department expands to eight veteran homes, two cemeteries and an ever-increasing statewide oversight responsibility at headquarters. Functions identified as needing expansion include the tracking and follow-up on prior audit findings, a central repository of lessons learned from prior audits, studies, reviews and other feedback processes, and the establishment of a corporate expertise on internal and management controls. This non-material finding identified as a result of this review should be corrected through the development and implementation of a management control review function within the Department. The Department intends to seek establishment of this function as part of the 2009-10 budget cycle.

For internal purposes only, the executive management team identified program areas that carry a level of risk such that they require continued monitoring by the executive management team. None of these were evaluated as material findings. The review highlighted some areas for continued diligence and oversight by executive management, but did <u>not</u> identify any additional high-risk activities not already being tracked and monitored by executive management. The Department has existing forums to provide semi-weekly or monthly oversight of program risks. These forums include direct involvement of the Secretary or the responsible program Deputy Secretary as appropriate for the level of program risk involved.

Major risks facing the Department, and the actions undertaken to ameliorate these risks are:

- <u>Activation of the Greater Los Angeles and Ventura County Veterans Home</u>. This project includes the activation of three new veterans homes in Lancaster, Ventura, and West Los Angeles. The risk relates to the detailed coordination of construction, staffing, support services and equipment necessary to ensure a timely activation. *Mitigation:* The Secretary chairs a monthly meeting with executive staff and project team members to track major milestones, and to identify and correct issues with the activation of these Homes.

- <u>Enterprise-wide Veterans Home Information System (EwVHIS) Information Technology Project</u>. This IT project develops and fields a new veterans home information system to

replace its aging information system. Risks are typical of those normally associated with the deployment of an enterprise-wide information system coupled with an aggressive timeline to provide deployment in time for the opening of the next three veteran homes being built, concurrently with deployment and testing at our existing homes. *Mitigation:* The Department is implementing this project in compliance with the Statewide Information Management Manual framework and under the close supervision of the Office of the State Chief Information Officer. Additionally the Department has an active steering committee and the Secretary chairs a monthly meeting (separate from the steering committee) with executive staff and project leadership to monitor progress, and to identify and correct issues with this project.

Conclusion

The review identified no material inadequacy or material weakness in the Department's systems of internal accounting and administrative control that prevent the Secretary from stating that the Department substantially complies with the intent of FISMA.

While the review conducted by the Department was very informative in evaluating internal and management controls, and identifying risks to program execution, it became clear during the exercise that the Department has reached a size and complexity wherein a permanent, well-structured internal control function must be established. This non-material finding identified as a result of this review will be corrected through the development and implementation of a management control review function within the Department.

The review highlighted some areas for continued diligence and oversight by executive management, but did not identify any additional major risks not already being tracked and monitored by executive management.

Appendices

Appendix A
Assessment Process Instructions

Task I
Prior Internal Control Audit Findings

Complete review of prior internal controls audit findings from 2005 to assess current status of open issues.

Task II
Survey of Prior Studies

Conduct a department-wide survey of any studies (to include: audits, studies, assist visits, licensing surveys, management reviews, reports, etc) assessing management controls or operational effectiveness conducted, or with reports dated, between January 1, 2006 and December 31, 2007. See attached list of examples of studies that should be reported. Submit using structured template titled "Program Studies Survey."

Task III
Operational Risk Assessments

Identify major projects, operational changes, or changes from external sources, currently under way or proposed in the next twelve months. Include any incomplete corrective actions identified in the "Survey of Prior Studies." Assess the level of risk to departmental operations through a structured risk assessment and management process. This assessment should be at a fairly high level (combine any multiple, specific risks into a statement of overall project risk). See attached list of potential projects/programs that need assessment. Submit your assessment using structured template titled "Risk Management Form."

Process – Using the attached Risk Management Form:

1. Identify and describe known and anticipated changes in program operations or projects under implementation. Major changes or projects should be identified separately. Each division should include, at a minimum, an overall assessment of inherent risks to their program.

2. For each major change, project, or program, identify risks associated with program execution, programmatic changes or project implementation. Develop a statement of overall project risk that is based upon the cumulative impact of the specific risks involved in project/program implementation.

3. Assess the probability of an adverse outcome in project implementation, program execution or through external influences on department programs as a result of the identified risks.

Probability Rating

High, Medium, Low

Risks considered as almost certain or very likely to occur should be rated High. Risks that may occur or have a 50/50 chance of occurring should be rated Medium. Risks considered unlikely to occur or that will probably not occur should be rated Low.

4. Assess the impact any adverse outcome might have on existing or new programs and/or project implementation.

Impact Rating

High, Medium, Low

If the risk represents a significant negative impact on budget, schedule, or quality, it should be rated High. Material impacts would significantly affect users, clients, or other key stakeholders, and should be rated Medium. If the risk does not represent a significant or material impact on budget, schedule or quality it should be rated Low.

5. Assess timeframe in which any adverse outcome might occur.

Time Frame

Long, Medium, Short

The time frame within which action must be taken in order to successfully mitigate the risk should be rated. If the time frame is less then six months, assign a rating of Short; for six months to one year assign a rating of Medium; and for greater then one year, assign a rating of Long.

6. Determine the risk exposure to the program/project using a structured matrix.

Risk Exposure Determination Matrix

		Probability		
		High	*Medium*	*Low*
Impact	*High*	High	High	Medium
	Medium	High	Medium	Low
	Low	Medium	Low	Low

7. Determine the risk severity to the program/project using a structured matrix.

Risk Severity Determination Matrix

		Exposure		
		High	*Medium*	*Low*
Time Frame	*Short*	High	High	Medium
	Medium	High	Medium	Low
	Long	Medium	Low	Low

8. Determine an appropriate strategy to manage the identified risks.

Research – Conduct additional research into the causes, apparent risk, and potential mitigation of the identified risks. An update to the risk assessment should be submitted when the research is completed. Identify areas of research and expected completion date under "Action Items."

Accept – The identified risk(s) is acceptable without any further action.

Mitigate – Action is required to reduce (mitigate) either the causes of the risk itself or the potential impact. Identify action items that will mitigate the risk under "Action Items."

Watch – No immediate action is required, however, the risk assessment should be reviewed periodically to identify any significant changes. Identify a timeline for future review under "Action Items."

9. Identify appropriate actions to implement the risk management strategy.

Task IV
Executive Prioritization

Using the results of the operational risk assessment process:
1. Review all Risk Management Forms with a risk severity of "High."
2. Evaluate if risk management strategy and actions are sufficient.
3. Prioritize risks to the Department.
4. Determine appropriate follow-on management reviews.

Task V
Report Writing

Report per FISMA instructions on results of operational risk assessment process.

Examples of Ongoing Projects,
Program Changes, & External Influences
Which may be worthy of a Risk Assessment

Homes Division
- Construction of GLAVC
- Activation of GLAVC
- Establishing new level of care (ADHC)
- Construction of Fresno & Redding
- Activation of Fresno & Redding
- Barstow SNF expansion
- Chula Vista census reduction
- Medical Staffing Shortfalls

Administrative Services Division
- EwVHIS Project
- IT Refresh Project
- Fiscal Operations Corrective Action Plan

Farm and Home Division
- QVMB Program

Each Division should submit an overall assessment of risks in the execution of their program.

Examples of Recent Studies

Homes Division
- DHS/CDPH/USDVA/DSS Licensing Surveys
- HIPPA Security Assessment
- MWR Annual Financial Statement Audits
- BSA/JLAC Audit of Yountville

Farm and Home Division
- Annual financial statement audits
- BSA Single Audit of Federally funded programs
- Management Controls Review

Veterans Services Division
- Semi-annual audit of CVSO workload reporting
- Contractor report on VSD audit program

Appendix B
Survey Reports

Title	Responsible Division/Office
Strategic Planning	Executive
Internal Control Audit	Executive
Annual Workforce Analysis, Upward Mobility, and Employment Goals for Persons with Disabilities	Equal Employment Office
HIPPA Security Assessment	Veterans Homes Division
CPS Review of Budget Process and Fiscal Controls	Financial Services Division
2005-06 Biennial Language Survey	Human Resources Division
Bureau of State Audits: Single Audit of Federally Funded State Programs	Farm & Home Division
Annual Financial Audit	Farm & Home Division
USDVA Loan Origination Compliance Audit	Farm & Home Division
Environmental Control Assessment	Farm & Home Division
Best Practices Review-Incontinence	Veterans Home Division
Best Practices Review-Patient Pain	Veterans Home Division
Department of Industrial Safety Inspection	VHC-Yountville
Department of Social Services RCFE Licensing Inspection	VHC-Yountville
Audit of Donations-Religious Offerings	VHC-Yountville
Audit of Segregation of Duties-PPE, Payroll Function, Donations Post Fund	VHC-Yountville
Napa County Department of Environmental Management Annual Medical Waste Management Program Inspection	VHC-Yountville
Office of State Fire Marshall Fire Safety Inspection	VHC-Yountville
Bureau of State Audits – Audit at the direction of the Joint Legislative Audit Committee	VHC-Yountville
California Board of Pharmacy Annual Inspection	VHC-Yountville
Department of Water Resources Inspection	VHC-Yountville
Department of Health Services Annual Certification Inspection	VHC-Yountville
Office of Statewide Health Planning and Development Inspection	VHC-Yountville
USDVA Annual Survey	VHC-Yountville
California Department of Public Health Inspection	VHC-Yountville
California Office of HIPPA Implementation Audit	VHC-Yountville
Department of Health Services Annual Certification Inspection	VHC-Chula Vista
California Department of Public Health Inspection	VHC-Chula Vista
Energy Conservation Consultants Energy Efficiency Review	VHC-Chula Vista